MORATORIUM IN BUSINESS RESCUE SCHEME AND THE PROTECTION OF COMPANY'S CREDITORS

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OPEN ACCESS

How to cite this paper: Nwafor, A. O. (2017). Moratorium in business rescue scheme and the protection of company's creditors. *Corporate Board: role, duties and composition, 13(1),* 59-67. http://dx.doi.org/10.22495/cbv13i1p6

ISSN Online: 2312-2722
ISSN Print: 1810-8601

Received: 14.12.2016
Accepted: 06.02.2017

JEL Classification: G34, K20
DOI: 10.22495/cbv13i1p6

Abstract

The concept of business rescue has been acknowledged as one of the innovative paths towed by the South African Companies Act 71 of 2008. The primary purpose of business rescue, as set down by the law, is to facilitate the rehabilitation of a company that is in financial distress. Attaining that purpose could, however, come at a price to the company's creditors. The law imposes a temporary restriction on legal proceedings, enforcement actions and the property rights of creditors. Unless the written consent of the business rescue practitioner or the leave of the court is first sought and obtained, the creditors cannot have any recourse against the company. The paper argues that the statutory moratorium could constitute an affront on the constitutional right of property, and further contends that while the business rescue practitioner whose governance role naturally supplants that of the board, would not ordinarily grant such consent, the courts are seemingly more neutrally disposed for recourse by the creditors who seek to exercise their rights against the company. In weighing the competing interests, greater consideration should be accorded to the creditors, the protection of whose interests are generally more compelling whenever the company is in financial distress.

Keywords: Moratorium, Business Rescue, Creditors, Business Rescue Practitioner, Statute, Courts

1. INTRODUCTION

The business rescue scheme is arguably one of the distinctive features of the South African Companies Act 71 of 2008. The scheme which supplants the concept of judicial management under the old statutory regime,[1] follows one of the stated purposes of the Act; to provide for the efficient rescue and recovery of financially distressed companies in a manner that balances the relevant rights and interests of all relevant stakeholders.[2] The courts have continued to lend judicial support to the stated legislative purpose through the interpretation and application of the relevant provisions in Chapter 6 of the Act, emphasising the significance of business rescue to the socio-economic development of the nation.[3]

It is axiomatic that realizing the goals of business rescue will always come at a cost to the creditors of the company. Binns-Ward J alluded to this in *Koen v Wedgewood Village Golf & Country Estate (Pty) Ltd*[4] where he stated that the mere institution of business rescue proceedings materially affects the rights of third parties to enforce their rights against the subject company. The affected 'third parties' were specifically identified by Traverso DJP in *Gormley v West City Precinct Properties (Pty) Ltd*[5] as the creditors who should have the strongest right to consultation regarding the development of business rescue plan as they have the greatest financial interest in the outcome of the business rescue. In *AG Petzetakis v Petzetakis*[6] Coetzee AJ observed that the creditors are affected in that business rescue proceedings temporarily protects the company concerned from legal

[1] Companies Act 61 of 1973, s 427.
[2] Section 7(k) CA 2008.
[3] See Koen v Wedgewood Village Golf & Country Estate (Pty) Ltd 2012 (2) SA 378 (WCC) para 14 where Binns-Ward J observed that it is clear that the legislature has recognised that the liquidation of companies more frequently than not occasions significant collateral damage, both economically and socially, with attendant destruction of wealth and livelihoods. It is obvious that it is in the public interest that the incidence of such adverse socio-economic consequences should be avoided where reasonably possible. Business rescue is intended to serve that public interest by providing a remedy directed at avoiding the deleterious consequences of liquidations in cases in which there is a reasonable prospect of salvaging the business of a company in financial distress, or of securing a better return to creditors than would probably be achieved in an immediate liquidation.
[4] Ibid para 10.
[5] [2012] 2 ZAWCHC 33 para 8.
[6] 2012 (5) SA 515 para 29.

proceedings by its creditors for the recovery of legitimate claims. This temporary restriction on the creditors from recourse against the company is statutorily instituted by the Act as moratorium which is sustained throughout the duration of the business rescue proceedings. The suspension which the law places on the creditors in the exercise of their rights while business rescue subsists and the protections afforded to the creditors in the circumstances are the focus of this discourse.

2. MORATORIUM ON CREDITORS' RIGHTS

There are two broad types of moratorium placed by the Act on the exercise of the creditors' rights against the company under business rescue. These could be discerned from section 128(1)(ii) which defines business rescue as proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for, *inter alia*, "a *temporary moratorium* on the rights of claimants against the company or in respect of property in its possession."[7] It could be asked, for curiosity sake, why temporary moratorium, when the word 'moratorium' itself, in its ordinary English expression, implies temporary restriction?[8] If the word 'temporary' does add any value at all to that provision, it can only be as an illustration of how brief the moratorium on the rights of creditors are expected to endure and to keep at the barest minimum the adverse impact of such restriction on the exercise of the rights of the affected company's creditors. Section 132(3) indicates that the business rescue proceedings should generally not exceed three months. Though the court has power, upon the application of the business rescue practitioner, to extend that period, such an extension should always have in contemplation the statutorily stated 'temporary' nature of the moratorium to ensure that this legislative scheme is not turned into a 'dubious'[9] mechanism to deprive the creditors of their legitimate right of recourse against the company to enforce mutual contractual obligations.[10]

The judicially recognized essence of the moratorium is simply to provide the company the required breathing space or the necessary period of respite to restructure its affairs in such a way as would allow it to resume operation on the basis of profitability.[11] The company ought not, as observed by James J in *Re David LIoyd & Co*,[12] because it has become insolvent or decided to restructure its affairs, be placed in a better position than the creditors of the company. In *Gormley v West City Precinct Properties (Pty) Ltd*[13] Traverso DJP warned that the moratorium provisions could be subjected to abuse by the company insiders seeking to use those provisions to frustrate creditors' rights and to stave off liquidation for ulterior motives. This note of caution is a reason for a close scrutiny by the courts of any applications by the company seeking judicial indulgence in matters of business rescue. It is trite that the interests of the creditors intrude whenever the company is in financial distress.[14] Although the duties of company directors are primarily owed to the company,[15] it is, however, normal for a company as a going concern to incur debts in the course of carrying on its business. Where this occurs, the interests of the creditors would become material factors which the company should have in contemplation while conducting its affairs. The focus of the company is legally expected to shift from profit making to addressing the concerns of the creditors who have interests in recovering debts owed to them by the company.[16] This realization should inform the judicial approach to the two broad sides of the statutory moratorium on the exercise of the creditors' rights envisaged under section 128(1)(ii) which could conveniently be classified as moratorium on legal proceedings and moratorium on proprietary rights.

3. MORATORIUM ON LEGAL PROCEEDINGS

The right of the company's creditors to institute legal proceedings against the company under business rescue is specifically restricted by section 133 of the Act. Section 133(1) provides as follows:

> (1) During business rescue proceedings, no legal proceeding, including enforcement action, against the company, or in relation to any property belonging to the company, or lawfully in its possession, may be commenced or proceeded with in any forum, except-
> (a) with the written consent of the practitioner;

[7] Emphasis added.
[8] See AS Hornby, *Oxford Advanced Learners' Dictionary of Current English 8th ed* (2010) at 960.
[9] To borrow the word of Binns-Ward J in *Koen* above note 4 para 10.
[10] See *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd* 2012 (2) SA 423 (WCC) para 3 per Eloff J who cautioned against the possible abuse of the business rescue procedure by rendering the company temporarily immune to actions by creditors so as to enable the directors or other stakeholders to pursue their own ends. In *AG Petzetakis v Petzetakis* 2012 (5) SA 515 para 29 Coetzee AJ emphasised that Chapter 6 of the Companies Act demonstrates a legislative intention that rescue proceedings must be conducted reasonably speedily. The reason being that pending rescue proceedings temporarily protects the company concerned from legal proceedings by its creditors for the recovery of legitimate claims without any input of the creditors and removes the unfettered management of the company from the directors. Thus delays will extend the duration of these temporary statutory arrangements, of which the duration is restricted by way of the procedure prescribed by the Act. Similarly, in *Blue Star Holdings (Pty) Ltd v West Coast Oyster Growers CC* 2013 (6) SA 540 (WCC) para 20 Gamble J warned that a business rescue application might well be used by an obstructive debtor intent on avoiding the obviously inevitable as part of its ongoing strategy to hinder a creditor from pursuing its lawfully permissible goal, and, experience tells one that the business rescue proceedings may then be advanced by the debtor with a degree of tardiness inversely proportional to the alacrity with which it initially approached the court.
[11] See *Murray NO and Another v FirstRand Bank Ltd* 2015 (3) SA 438 (SCA) para 14, *Madodza (Pty) Ltd v ABSA Bank Ltd* [2012] ZAGPPHC 165 para 12, *Chetty v Hart* [2015] 4 All SA 401 para 28. *Environmental Agency v Administrator of Rhondda Waste Disposal Ltd* [2000] EWCA Civ 38 para 34.
[12] (1877) 6 ChD 339 at 344.
[13] [2012] ZAWCHC 33 para 15.
[14] See *Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd* [2003] 2 BCLC 153 para 74 per Mr Leslie Kosmin QC (sitting as a Deputy High Court Judge) who observed that "Where a company is insolvent or of doubtful solvency or on the verge of insolvency and it is the creditors' money which is at risk the directors, when carrying out their duty to the company, must consider the interests of the creditors as paramount and take those into account when exercising their discretion." See also *Kinsela v Russell Kinsela Pty Ltd* (1986) 10 ACLR 395(NSWCA), *The Secretary of State for Business, Innovation and Skills v Doffman* [2010] EWHC 3175 (Ch) paras 44-45.
[15] *Multinational Gas and Petrochemical Co Ltd v Multinational Gas and Petrochemical Services Ltd* [1983] Ch 258 at 288, *Percival v Wright* [1902] 2 Ch 421 at 426, *Colin Gwyer v London Wharf* [2003] 2 BCLC 153 para 72, *Re Chez Nico (Restaurants) Ltd* [1992] BCLC 192 at 208h, *Peskin v Anderson* [2001] 1 BCLC 372 para 30, *Towcester Racecourses Co Ltd v The Racecourse Association Ltd* [2003] 1 BCLC 260 para 18, *Re MDA Investment Management Ltd* [2004] 1 BCLC 217. See generally s 76 CA 2008.
[16] In *Winkworth v Edward Baron Development Co Ltd* [1986] 1 WLR 1512, Lord Templeman held that directors owe a fiduciary duty to the company and its creditors, present and future, to ensure that its affairs are properly administered and to keep the company's property inviolate and available for the repayment of its debts. See also *Lonhro Ltd v Shell Petroleum Co Ltd* [1980] 1 WLR 627 (HL) at 634 per Lord Diplock, *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250 (CA), *Re Pantone 485 Ltd* [2002] 1 BCLC 266 (HC), *Colin Gwyer and Associates Ltd v London Wharf (Limehouse) Ltd* [2003] 2 BCLC 153. See generally J. Lowry, 'The Recognition of Directors Owing Fiduciary Duties to Creditors - Re Pantone 485 Ltd and Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd' *International Corporate Rescue* available at http://www.chasecambria.com/site/journal/article.php?id=83, accessed on 22/09/16.

(b) with the leave of the court and in accordance with any terms the court considers suitable.[17]

The courts have continued to grapple with the interpretation and application of the key elements of this provision while always striving to accord respect to the judicially identified legislative intention that informed the enactment and the philosophy behind the concept of business rescue as a whole.[18] In *Murray NO and Another v Firstrand Bank Ltd*,[19] for instance, Fourie AJA of the Supreme Court of Appeal, while interpreting section 133(1), proceeded from the cardinal rule which accords respect to the language of the statute itself, read in context and having regard to the purpose of the provision, the background to the preparation and production of the document in discovering the intention of the legislature.[20] He said: "[t]he way I see it, the legislature intended to allow the company in distress the necessary breathing space by placing a moratorium on legal proceedings and enforcement action in any forum, but not to interfere with the contractual rights and obligations of the parties to an agreement."[21]

The inherent question from this judicial opinion on the intention of the legislature lies on whether a moratorium could indeed operate in that context without some level of interference, not necessarily the alteration, of some existing legal rights? Moratorium by its nature cannot operate in a vacuum. Legal proceedings and enforcement actions are, by their nature, necessarily ancillary (if not expressly stated) parts of contractual rights and obligations of parties to an existing agreement. Putting a wedge on legal proceedings emanating from a contractual obligation does invariably interfere with the existing contractual right. The application in context of section 133(1), galvanized by the legislative intention of allowing some breathing space to a company in financial distress to return to status of profitability, would not unreasonably entail casting the scope of that provision as wide as possible[22] to include every conduct of the creditor, based on existing contract with the company, that could materially affect the realization of the purpose of that provision. This would strip the creditors of all vestiges of protection in all contractual relationships with the company during the subsistence of the moratorium except to the extent specifically allowed by that provision. However, the Supreme Court's decision in *Murray* suggests that the court could still view the provision through the lens of the creditor. In that case, the exercise by the creditor of the right of repossession of goods, after the cancellation of the contract, with the consent of the business rescue practitioner, though not in writing as required by the statute, was upheld by the court. The court held that the absence of written consent does not vitiate the consent. In a later decision of the Supreme Court in *Chatty v Hart*[23] the court had stated the essence of the requirement of the business rescue practitioner's consent as being to give him the opportunity, after his appointment, to consider the nature and validity of any existing or pending claim and how it is to be dealt with, either by settling it or continuing with the litigation. In particular, to assessing how the claim will impact on the well-being of the company and its ability to regain its financial health. Thus, the statutory moratorium is judicially recognized as a defence *in personam*, a personal privilege or benefit in favour of the company.[24] Being a personal benefit, the company can, through its appointed representative, apply it in a manner that it deems most appropriate to it, and could even waive the benefit.

The Supreme Court of Appeal in *Murray* also gave judicial expression to the operative phrases in section 133(1) such as 'legal proceedings', 'enforcement action' and 'forum' as used in that provision. Fourie AJA observed:

> In the context of s 133(1) of the Act, it is significant that reference is made to 'no legal proceeding, including enforcement action'… The inclusion of the term 'enforcement action' under the generic phrase 'legal proceeding', seems to me to indicate that 'enforcement action' is considered to be a species of 'legal proceeding' or, at least, is meant to have its origin in legal proceedings… A 'forum' is normally defined as a court or tribunal… its employment in s 133(1) conveys the notion that 'enforcement action' relates to formal proceedings ancillary to legal proceedings, such as the enforcement or execution of court orders by means of writs of execution or attachment.[25]

This decision by the Supreme Court has implicitly overruled the High Court position in *Madodza (Pty) Ltd v ABSA Bank Ltd*[26] where Tolmay J held that the cancellation of the vehicle finance agreement effected pursuant to a court order granted prior to the commencement of the business rescue proceedings could be enforced during the subsistence of the rescue proceedings to enable the respondent recover possession of the vehicles.

Although the Supreme Court in *Murray* had interpreted 'enforcement action' as emanating from the generic phrase 'legal proceeding', thus, suggesting the occurrence of chain of events within the operative course of the statutory moratorium to bar the exercise of the creditor's right, the framing of section 133(1) which uses a comma to separate 'legal proceeding' from 'enforcement action' suggests that both operative phrases could also be read disjunctively. In other words, the provision implies that no 'legal proceedings' or 'enforcement

[17] Other exceptions are listed in paragraphs c-f of s 133(1) which includes set-off, criminal proceedings, property held by company as trustee and proceedings by a regulatory authority.
[18] Claassen J in *Oakdane Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd* [2012] 2 All SA 433 (GSJ) para 12 stated that the general philosophy permeating through the business rescue provisions is the recognition of the value of the business as a going concern rather than the juristic person itself. Hence the name business rescue and not company rescue.
[19] 2015 (3) SA 438 (SCA) para 30.
[20] See *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) para 18.
[21] *Murray NO* above note 19 para 40.
[22] See Purdette, Delport, Quintus Vorster, David Burdette, Irene-Marie Esser & Sulette Lombard, *Henochsberg on the Companies Act 71 of 2008* vol 1 (2015) at 480(12) where the authors stated that although no definition of the term 'legal proceeding' or 'enforcement action' is provided in Chapter 6, it is clear that the intention of the provision is to cast the net as wide as possible in order to include any conceivable type of action against the company. See *Madodza (Pty) Ltd v ABSA Bank Ltd* [2012] ZAGPPHC 165 para 12. In *Investec Bank Ltd v Bruyns* 2012 (5) SA 430 (WCC) para 16 Rogers AJ described section 133(1) as a general provision that affords the company protection against legal action on claims in general.
[23] [2015] 4 All SA 401 para 28.
[24] See *Investec Bank Ltd v Bruyns* 2012 (5) SA 430 (WCC) para 18 per Rogers AJ.
[25] *Murray NO* above note 20 para 32. Emphasis his Lordship's.
[26] [2012] ZAGPPHC 165 para 8.

action' may be commenced or proceeded with while the company is under business rescue. Reading it in such a manner entails that even when court action is already concluded and judgment entered before the commencement of business rescue, the enforcement of the order of court cannot be proceeded with while business rescue is in place.

The Supreme Court in *Murray* understandably did not dwell much on the meaning of the phrase 'legal proceeding' as that was not in issue.[27] However, in a later decision by the same court[28] Cachalia JA, while interpreting section 133(1), stated that "the phrase legal proceeding may, depending on the context within which it is used, be interpreted restrictively, to mean court proceedings or more broadly, to include proceedings before other tribunals including arbitral tribunals. The language employed in s 133(1) itself suggests that a broader interpretation commends itself." The broad approach seems indeed to be the preferred approach in pursuing the legislative intention. The English courts have adopted a similar approach in interpreting a similar provision under the UK Insolvency Act of 1986. Section 11(3)(d) of the Insolvency Act provides as follows:

> (3) During the period for which an administration order is in force -
> (d) *no other proceedings* and no execution or other legal process may be commenced or continued, and no distress may be levied, against the company or its property except with the consent of the administrator or the leave of the court and subject (where the court gives leave) to such terms as aforesaid.[29]

While construing this provision in *Environment Agency v Administrator of Rhondda Waste Disposal Ltd*,[30] Scott Baker LJ, in a unanimous decision of the Court of Appeal, said:

> It seems to me that they have a plain and clear meaning. The words: "No other proceedings and no execution or other legal process may be commenced or continued... against the company or its property" cover on their face all judicial and quasi judicial proceedings. There is no qualification to "other proceedings". The sections do not say "no other civil proceedings"; nor is there any reference to excluding any particular category of proceedings…The words used are entirely apt… to include all judicial proceedings.

In *Winsor v Special Railway Administrators of Railtrack Plc*[31] Woolf CJ aligning with the decision of Sir Nicolas Brown-Wilkinson VC in *Powdrill*, observed that it is sufficient to note that section 11(3)(d) applies to a wide category of legal or quasi-legal proceedings. None the less the other proceedings have to be "*against*" the company or its property. Similarly, in *Air Ecosse Ltd and Others v Civil Aviation Authority*[32] Lord McDonald expressed his conviction that the restrictions in section 11(3) are directed against the activities of the creditors of the company which might otherwise be available to them in order to secure or recover their debts. This, incidentally, is the position adopted by the South African courts. In *Chetty v Hart*[33] Cachalia JA had emphasised towards the end of the judgment, that it bears mentioning that the moratorium envisaged by section 133(1) only suspends legal proceedings *against* a company under business rescue and not *by* the company. In that context, the law has certainly placed the company under business rescue in a more advantageous position than the creditors. This should be of essence when the courts are considering applications for leave by a creditor to institute legal action against the company during the subsistence of the moratorium. Some level of fairness ought to be adopted in weighing the contending interests of the creditors against the company always bearing in mind that the interest of the creditors deserves stronger protection when the company is in financial distress.

4. MORATORIUM ON PROPRIETARY RIGHTS

The exercise of right by a creditor over property owned by the creditor but in the possession of the company under business rescue is suspended by the Act. Section 134(1)(c) provides the scope of the restriction imposed on the creditors' proprietary right as follows:

> (1) Subject to subsections (2) and (3), during a company's business rescue proceedings-
> (c) despite any provision of an agreement to the contrary, no person may exercise any right in respect of any property in the lawful possession of the company, irrespective of whether the property is owned by the company, except to the extent that the practitioner consents in writing.[34]

This provision strikes directly on the private agreement between the creditor and the company. Every right which the creditor may have on the property, even as little as demanding for rent accruing from the creditor's property occupied by the company, is suspended.[35] The full import of this provision could not be explored by the Supreme Court in *Murray* as the facts revealed that the cancellation of the agreement and repossessing of the goods by the creditor were indeed done with the consent of the business rescue practitioner. The only contested issue that invoked the examination of section 134(1)(c) borders merely on the nature of the consent which the provision requires to be in writing. The Supreme Court finding that the requirement of consent is merely directory and not peremptory is in tandem with the exercise of private right. The company cannot be heard to say: 'I did not consent in writing as required of me by the law, I only consented orally'. The company cannot rely on its own fault as a defence to the exercise of the creditor's right. In

[27] The court merely indicated that the term 'legal proceeding' is well-known in South African legal parlance and usually bears the meaning of a lawsuit or 'hofsaak'. The court cited *Van Zyl v Euodia Trust (Edms) Bpk* 1983 (3) SA 394 (T) at 399C-D and *Lister Garment Corporation (Pty) Ltd v Wallace NO* 1992 (2) SA 722 (D) at 723G-H to support the assertion.
[28] *Chetty v Hart* [2015] 4 All SA 401 para 35.
[29] Emphasis added.
[30] [2000] EWCA Civ 38 para 27. See also *Bristol Airport Plc v Powdrill* [1990] Ch 744 at 766 where Sir Nicolas Brown-Wilkinson VC had emphasised that the meaning of the words 'no other proceedings may be commenced or continued' is that the proceedings in question are either legal proceedings or quasi-legal proceedings such as arbitration.
[31] [2002] EWCA Civ 955 para 8. Emphasis his Lordship's.
[32] (1987) 3 BCC 492 at 494.
[33] [2015] 4 All SA 401 para 47.
[34] Subsections (2) and (3) seeks to mitigate the adverse effects of this provision on the creditor by restricting the exercise of the powers of the business rescue practitioner over the creditor's property.
[35] See *AIB Capital Markets Plc & Anor v Atlantic Computer Systems Plc & Ors* [1990] EWCA Civ 20 where the court held, in relation to a similar provision under the English Act, that the owners of property, and of charges over property, are disabled from exercising their proprietary rights unless the administrator consents or the court gives leave.

Chetty v Hart[36] the Supreme Court emphasised that the essence of the requirement for consent to be sought from the practitioner and given in writing is to promote legal certainty and avoid future disputes. Non-compliance with the written requirement does not therefore have a vitiating effect on the consent as given.

Beyond the issue of consent is the need to explore in context the specific meanings of the operative words in that provision which are 'ownership' and 'possession' of property. Where the company is the owner of the property which the creditor seeks to seize in the exercise of a contractual or legal right, the law is fairly settled. The creditor cannot exercise the right over such property without the written consent of the business rescue practitioner while business rescue proceedings are subsisting. Where the company merely asserts the right of possession over the property, especially where the property is in actual possession of a third party, there will always be the question as to whether the property is indeed in the possession of the company? What does being in possession entail? In *Towers and Co Ltd v Gray*[37] Lord Parker CJ observed that the term 'possession' is always giving rise to trouble. His Lordship buttressed this assertion by referring to the statement of Earl Jowitt in *United States of America and Republic of France v Dollfus Mieg et Cie SA and Bank of England*[38] that "[t]he person having the right to immediate possession is, however, frequently referred to in English law as being the 'possessor' - in truth the English law has never worked out a completely logical and exhaustive definition of 'possession'." His Lordship expressed his stand on this unsettled term leaning in favour of contextual approach where he said:

> For my part I approach this case on the basis that the meaning of 'possession' depends upon the context in which it is used ... In some contexts, no doubt, a bailment for reward subject to a lien, and where perhaps some period of notice has to be given before the goods can be removed, could be of such a nature that the only possession that there could be said to be would be possession in the bailee. In other cases it may well be that the nature of the bailment is such that the owner of the goods who has parted with the physical possession of them can truly be said still to be in possession.

The Constitutional Court had in *FNB v The Commissioner for the South Africa Revenue Services*[39] held that the possession of a movable requires both physical control (*detentio*) and the necessary state of mind (*animus*). When used in a statute the context will determine what state of mind is required for possession in terms of such statute.[40] The UK Court of Appeal in *AIB Capital Markets Plc & Anor v Atlantic Computer Systems Plc & Ors*[41] preferred a purposive approach to the interpretation of 'possession' in a similar provision in section 11(3)(c) of the UK Insolvency Act of 1986.[42] Nicholls LJ stated that:

> The paragraph is dealing with goods which, as between the company and its supplier, are in the possession of the company... Those goods are to be protected from repossession unless there is either consent or leave. It is immaterial whether they remain on the company's premises, or are entrusted by the company to others for repair, or are sub-let by the company as part of its trade to others.

The provision of section 134(1)(c) is amenable to a similar line of construction taking into consideration the legislative intention and purpose of that provision as the guiding approach. The provision refers to 'lawful possession' and not 'actual possession'. This would ordinarily include actual and constructive possession so long as the company can legitimately lay a claim on the property while under business rescue.

Can this provision be impugned as an expropriation of property contrary to the constitutional demands? Section 25(1)(2)(4) of the 1996 Constitution provides *inter alia:*

> 25. Property–
> (1) No one may be deprived of property except in terms of law of general application, and no law may permit arbitrary deprivation of property.
> (2) Property may be expropriated only in terms of law of general application-
> (a) for a public purpose or in the public interest; and
> (b) subject to compensation, the amount of which and the time and manner of payment of which have either been agreed to by those affected or decided or approved by a court.
> (4) For the purposes of this section –
> (a) the public interest includes the nation's commitment to land reform, and to reforms to bring about equitable access to all South Africa's natural resources; and
> (b) property is not limited to land.

It is judicially settled that the above provision affords protection to the holding of property.[43] The protection applies to both natural and juristic persons, and could have grave consequences if the entitlement is denied.[44] The protected property as indicated in section 25(4)(b) is not limited to land, it extends to the right of ownership of corporeal movables.[45] The relationship between deprivation and expropriation in the context of the provision was explored in *FNB's case.* Ackermann J explained that "any interference with the use, enjoyment or exploitation of private property involves some deprivation in respect of the person having title or

[36] [2015] 4 All SA 401 para 46.
[37] [1961] 2 QB 351 at 361.
[38] [1952] AC 582 at 605.
[39] 2002 (4) SA 768.
[40] See *S v Brick* 1973 (2) SA 571 (A) at 579H and *S v Adams* 1986 (4) SA 882 (A) at 891D-E. which were referred to by the court.
[41] [1990] EWCA Civ 20 para 42.
[42] The section provides that during the period for which an administration order is in force: (c) no other steps may be taken to enforce any security over the company's property, or to repossess goods in the company's possession under any hire purchase agreement, except with the consent of the administrator or the leave of the court and subject (where the court gives leave) to such terms as the court may impose.
[43] See *Ex Parte Chairperson of the Constitutional Assembly: In Re Certification of the Constitution of the Republic of South Africa 1996* 1996 (4) SA 744 (CC) para 72.
[44] See *FNB* above note 39 para 45 where Ackermann J stated that "denying companies entitlement to property rights would …lead to grave disruptions and would undermine the very fabric of our democratic State. It would have a disastrous impact on the business world generally, on creditors of companies and, more especially, on shareholders in companies. The property rights of natural persons can only be fully and properly realised if such rights are afforded to companies as well as to natural persons." See also *Investigating Directorate: Serious Economic Offences v Hyundai Motor Distributors (Pty) Ltd* 2001 (1) (SA) 545 (CC) para 18.
[45] *FNB* ibid para 49(c).

right to or in the property concerned… If the deprivation amounts to an expropriation, then it must pass scrutiny under section 25(2)(a) and make provision for compensation under section 25(2)(b)."[46]

Section 134(1)(c) certainly bears some element of interference with the exercise of the creditor's right of property. Such interference could, however, be justified as being in terms of the law of general application and that it is not arbitrary.[47] Thus, there is no issue on compliance with section 25(1) of the Constitution. A similar conclusion cannot, however, be attained in relation to section 25(2). The contention here is that the provision of section 134(1)(c) of the Companies Act amounts to an expropriation of property to the extent that the creditors are denied of rights (albeit temporarily) over their property in possession of the company under business rescue. The purpose of the expropriation is convincingly settled as being in the public interest or for public purpose.[48] The requirement of section 25(2)(a) of the Constitution is thus satisfied to that extent. But not so with section 25(2) (b) which demands that compensation should be paid to the owners of the expropriated property. In *AIB Capital Markets Plc & Anor v Atlantic Computer Systems Plc Ors*[49] a similar provision in section 11(3) of the UK Insolvency Act of 1986 was described by the Court of Appeal as having an expropriating effect to the extent that it precludes the owners of land or goods from exercising their proprietary rights while the company is under administration. The court was, however, persuaded that, among others, the right granted the creditors to apply to the court for leave, in the absence of agreement by the administrator, to exercise their rights over such property, provides sufficient safety valve for the creditors.

Although similar safe guards are incorporated in sections 134(1) (c) and 133(1) of the Companies Act,[50] they are arguably insufficient to supplant the mandatary constitutional requirement for compensation for expropriation of property. It would seem that the only acceptable ground upon which the creditors could be denied compensation is when the business rescue is initiated by the creditors as they could under section 131 of the Act. In such an instance, they would be deemed to have accepted the consequences that are statutorily attendant to such proceedings including the expropriation of their proprietary rights.

5. PROTECTION OF THE CREDITORS' RIGHTS

The safety valves which the law has built into the provisions of sections 133(1) and 134(1) (c) for the protection of the proprietary rights of creditors are the right to seek the written consent of the business rescue practitioner or the leave of the court to exercise their rights. The English court's interpretation of similar provisions in section 11(3) (c) (d) suggests that the creditor can approach the court only after the administrator has failed to grant his consent.[51] The South African courts seem to tow a different approach in that respect. In *Chetty v Hart*[52] for instance, Cachalia JA emphasised that section 133(1) (a) is not a shield behind which a company not needing the protection may take refuse to fend off legitimate claims in that:

> s 133(1)*(b)*, which is to be read disjunctively with s 133(1)*(a)* because of the use of the word 'or' in exceptions *(a)* to *(e)*, permits a creditor to seek the court's imprimatur to initiate or continue legal proceedings against the company in the event of a practitioner's refusal to give consent, *or directly, even without the permission of the practitioner having been sought*. So s 133(1)*(a)* is not an absolute bar to legal proceedings being instituted or continued against a company under business rescue.

There are good reasons to suggest that the judicial position in South Africa would afford greater protection to the creditors than the English counterpart. Admittedly, there are a number of safe guards in the statute such as section 138(1)(e)(f) aimed at ensuring some level of independence in the discharge of the responsibilities of the business rescue practitioner to the company in the course of the business rescue proceedings.[53] Section 139(2) (e) similarly declares that the practitioner could be removed for lack of independence. The same is true of section 140(3) (a) which provide that the practitioner is an officer of the court. The bottom line, however, remains that the practitioner, in assuming the position of running the company's affairs during business rescue, supplants the board[54] and discharges his functions as an agent of the company. He also receives remuneration from the company.[55] These considerations would expectedly compel the practitioner to place the interest of the company above other interests including those of the creditors. The desire to justify the reason for his appointment could becloud his sense of judgment in addressing requests from individual creditors in matters of concern to the creditors. The courts are seemingly in a better position to guarantee fair treatment to the creditors in matters of concern to the creditors, though the stakes could be higher in terms of time and expense.

Where the creditor decides to seek the consent of the practitioner first, the practitioner is expected to decide on the request responsibly and expeditiously. The power of the practitioner to grant or decline consent must not be used as a bargaining counter in a negotiation to the advantage of one creditor or disadvantage of the other. As an officer

[46] Ibid para 49(i)(k).
[47] Ackermann J in *FNB* ibid pp 68-69 para (r) while construing the word 'arbitrary' stated that a deprivation of property is "arbitrary" as meant by section 25 when the "law" referred to in section 25(1) does not provide sufficient reason for the particular deprivation in question or is procedurally unfair.
[48] See s 128(1)(b)(iii) which provides the purpose of business rescue as being to develop and implement a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities, and equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, if it is not possible for the company to so continue in existence, results in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company.
[49] [1990] EWCA Civ 20.
[50] See *Chetty v Hart* [2015] 4 All SA 401 para 45 where the court observed that the exercise of a creditor's rights is therefore suspended during the moratorium, but this is balanced by the other protections afforded it in the section itself.
[51] See *AIB's case* above note 49 para 36 where the court held that built into section 11 itself is provision for an application to the court for leave, in the absence of agreement by the administrator.
[52] [2015] 4 All SA 401 para 40. Emphasis added. The Supreme Court reiterated that position in para 45 of the same judgment.
[53] The section provides that; (1) A person may be appointed as the business rescue practitioner of a company only if the person - (e) does not have any other relationship with the company such as would lead a reasonable and informed third party to conclude that the integrity, impartiality or objectivity of that person is compromised by that relationship; and (f) is not related to a person who has a relationship contemplated in paragraph (d). Note that para (d) here should refer to para (e) as para (d) does not deal with the issues of relationship.
[54] See s 140(1)(a).
[55] See s 143(1)(2).

of the court, the practitioner should endeavour to decide as close as the court would have done in similar circumstances.[56] Where the creditor approaches the court for leave, the considerations for the exercise of the judicial discretion, as stated by the court in *AIB*, include the consequences which the grant or refusal of leave would have, the financial position of the company, the period for which the administration (business rescue) order is expected to remain in force, the end result sought to be achieved, and the prospects of that result being achieved,[57] while always bearing in mind that the purpose of the power to give leave is to enable the court to relax the prohibition where it would be inequitable for the prohibition to apply.[58] These considerations require the weighing of the competing interests with preference given to the creditors who will bear the greater risk upon failure of the business rescue proceedings.[59]

Beyond the need for the exercise of the judicial discretion in favour of the creditors, lies the legal consequence of legal proceedings commenced by the creditor to vindicate his proprietary right without first obtaining the consent of the practitioner or leave of the court. Neither section 133(1) nor section 134(1) (c) embodies any legal consequence for non-compliance. The approach by the English courts, in interpreting similar provisions under the English law, is that the effect of the provisions is not to render a nullity proceedings brought without the consent of the administrator or the leave of court but that such proceedings are liable to be stayed. This position which emanated from the decision of Lord Coulsfield in *Carr v British International Helicopters Ltd*,[60] was followed by Underhill J in *Unite the Union v Sayers Confectioners Ltd*[61] where the Judge held that he could see no reason why the decision in *Carr* would not apply equally in that case. Although not bound by that decision, the Judge admitted that he had no reason not to follow it.

The initial South African court's approach to the application of those provisions is to decline jurisdiction where leave was not obtained prior to the commencement of an action. This was implicit in the decision of Kgomo J in *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies*[62] where the Judge held that once a business rescue plan is adopted, no legal proceedings can be instituted against the respondent except with prior authorisation by the court. "It will be incongruous or incomprehensive, if not also illogical for the applicant to have embarked on these proceedings well knowing that they are not permitted and can only be instituted after a court had granted leave."

This line of reasoning was not followed by the Supreme Court in the more recent decisions. In *Chetty v Hart*[63] the Supreme Court held that section 133(1)(a) constitutes a mere procedural bar to the initiation or continuation of legal proceedings. The court emphasised that the object of the provision is to prevent the practitioner from being inundated with legal proceedings without sufficient time within which to consider whether or not the company should resist them and to prevent the company that is financially distressed from being dragged through litigation while it tries to recover from its financial woes. Its effect is to stay legal proceedings except in those circumstances mentioned in section 133(1)*(a)* to *(e)*. Section 133(1)*(a)* is not a shield behind which a company not needing the protection may take refuge to fend off legitimate claims. Thus, the non-compliance with that provision does not nullify the proceedings. Similarly, in *Murray NO and Another v Firstrand Bank Ltd*[64] the court held that the requirement of written consent of the practitioner in section 134(1)(c) is merely directory and not peremptory, and the fact that the statute did not provide any sanction for non-compliance is an indication that the failure to meet the requirement of written consent would not constitute an action taken under that provision a nullity.

The language of section 133(1) lends credence to the Supreme Court position. The provision commences with "During business rescue proceedings", thus indicating that its operation is only for a specific period. Then the active part; "no legal proceedings … *may* be commenced or proceeded with in any forum".[65] The word 'may' is generally directory unless a different intention is indicated. The words 'commenced' and 'proceeded' refer to, not only fresh actions, but also pending matters. If the provision is read as implying that every action commenced under that provision is a nullity, the same will apply to all proceedings pending in any forum prior to the commencement of the Act. This would be absurd. The legislature did not set out to deprive creditors of their rights of recourse to the court. The intention of the legislation, as severally emphasised by the courts[66], is merely to grant a period of respite to the company under business rescue from litigation by the creditors. This line of reasoning is re-enforced by section 133(3) which provides that "[i]f any right to commence proceedings or otherwise assert a claim against a company is subject to a time limit, the measurement of that time *must* be suspended during the company's business rescue proceedings."[67] The word 'must' in that provision contrasts sharply with the word 'may' in section 133(1). This suggests that the creditors should not be unduly subjected to prejudice in the exercise of their rights of action on account of the subsistence of business rescue proceedings.[68] Suspending or staying of proceedings is certainly more sensible and businesslike than any suggestion that such proceedings without the consent or leave of court by the creditor is a nullity. This accords with the spirit and object of the Act which the courts are instructively enjoined to pursue under section 158.[69]

[56] See *AIB* above note 51 paras 34 & 35.
[57] Ibid para 30.
[58] Ibid para 83.
[59] See *Bristol Airport Plc v Powdrill* [1990] 2 WLR 1362 at 1379, *Scientific Research Council v Nasse* [1980] AC 1028 at 1062, *Lazari GP Ltd v Jervis & Ors* [2012] EWHC 1466 (Ch) para 16, *Royal Trust Bank v Buchler* [1989] BCLC 130.
[60] [1994] ICR 18.
[61] [2009] UKEAT 0513_08_0902 para 5.
[62] [2013] 2 AGPJHC 109 paras 70-71.
[63] [2015] 4 All SA 401 paras 38-40.
[64] 2015 (3) SA 438 (SCA) para 24.
[65] Emphasis added.
[66] See *Murray NO and Another v FirstRand Bank Ltd* 2015 (3) SA 438 (SCA) para 14, *Madodza (Pty) Ltd v ABSA Bank Ltd* [2012] ZAGPPHC 165 para 12, *Chetty v Hart* [2015] 4 All SA 401 para 28.
[67] Emphasis added.
[68] See *Panama Properties (Pty) Ltd and Another v Nel NO and Others* 2015 (5) SA 63 (SCA) para 26 where the Supreme Court held that a sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document.
[69] Section 158(b) provides that when determining a matter brought before it in terms of this Act, or making an order contemplated in this Act, the court- (i) must promote the spirit, purpose and objects of this Act; and (ii) if any provision of this Act, or other document in terms of this Act, read in its context, can be reasonably construed to have more than one meaning, must prefer the meaning that best promotes the spirit and purpose of this Act, and

The creditors, the exercise of whose rights is already abridged by the statutory moratorium, should not be subjected to any further avoidable hardship by being shut out entirely from the judicial process while the moratorium subsists.

6. CONCLUSION

The importance of the company to the socio-economic development of the nation is seemingly the key motivating factor for the statutory scheme on business rescue. The quest to salvage a company in financial distress, however, comes at a cost to the creditors whose right of recourse to the court to vindicate their contractual and proprietary rights are suspended during the subsistence of the business rescue proceedings. The need to minimize the adverse impact of the business rescue on the creditors whose rights are placed in abeyance, demands that the proceedings be conducted expeditiously with the attendant obligation on the courts to guard against using that statutory scheme by unconscionable company directors as a subterfuge to fend their own nests by preventing the creditors from enforcing their legitimate rights against the company or the company's assets. The realization that the protection of the interests of the creditors is of paramount consideration whenever the company is in financial distress should inform judicial attitude in applying the provisions on moratorium on the rights of the creditors while the company is undergoing business rescue.

The purposive approach employed by the Supreme Court of Appeal in *Murray*[70] in interpreting section 133(1) of the Act as aimed at granting the company in financial distress a breathing space by putting a wedge on the creditors' right of legal proceedings and enforcement action may not be faulty in context. But the same cannot be said of the suggestion that that provision does not interfere with the contractual rights of the creditors. The fact that the creditors cannot enforce their rights as they could ordinarily have done under the contract constitutes an interference with the creditors' contractual right. This is inherent in the Supreme Court of Appeal's decision in *Chetty*[71] that section 133(1) only suspends legal proceedings 'against' a company under business rescue and not 'by' the company. The implication of that decision is that the company under business rescue is accorded greater statutory indulgence than the creditors.

The suspension on legal proceedings seemingly strengthens the moratorium on the creditors' proprietary right in section 134(1)(c) of the Act. It is arguable that the interference with the creditors' proprietary right under section 134(1)(c) amounts to expropriation of property with the attendant constitutional implications. Though the nature of the expropriation is as such as would satisfy the requirements of public purpose and public interest as demanded by section 25(2)(a) of the Constitution, the absence of any provision for compensation as required by section 25(2)(b) exposes section 134(1)(c) to constitutional challenge.

The approach by the Supreme Court of Appeal in *Chetty* on the creditors' exercise of options provided in section 133(1)(a)(b) to either seek the consent of the business rescue practitioner or the leave of the court to exercise their legal rights seems more amenable to the plight of the creditors than the UK court's approach which insists that the creditor should first explore the prospect of obtaining the administrator's consent prior to recourse to the judicial discretion.[72] The propensity is always higher that the practitioner who supplants the board in the conduct of the affairs of the company, receives remuneration from the company, and would ordinarily want to showcase his business acumen, would most likely prefer the interest of the company to that of the individual creditors. The courts are thus more neutrally placed to weigh the contending interests on a fair balance, and should give greater consideration to the interests of the creditors who stand to lose more in the event of the failure of the practitioner to rescue the company in financial distress.

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will best improve the realisation and enjoyment of rights.

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[71] See above note 33.

[72] See *AIB* above note 51.

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